THE ECONOMICS OF TRANSITION

The Economics of Transition

**From Socialist Economy to
Market Economy**

MARIE LAVIGNE

Macmillan Education

ISBN 978-0-333-52731-3 ISBN 978-1-349-24137-8 (eBook)

DOI 10.1007/978-1-349-24137-8

THE ECONOMICS OF TRANSITION

Copyright © 1995 by Marie Lavigne

Softcover reprint of the hardcover 1st edition 1995 978-0-333-52730-6

All rights reserved. No part of this book may be used or reproduced in any manner whatsoever without written permission except in the case of brief quotations embodied in critical articles or reviews.

For information, address:

St. Martin's Press, Scholarly and Reference Division,
175 Fifth Avenue, New York, N.Y. 10010

First published in the United States of America in 1995

ISBN 978-0-312-12720-6 (cloth)

ISBN 978-0-312-12721-3 (paper)

Library of Congress Cataloging-in-Publication Data

Lavigne, Marie, 1935–

The economics of transition : from socialist economy to market economy / Marie Lavigne.

p. cm.

Includes bibliographical references and index.

ISBN 978-0-312-12720-6. — ISBN 978-0-312-12721-3 (pbk.)

1. Europe, Eastern—Economic policy—1989– 2. Free enterprise—Europe, Eastern, 3. Post-communism—Europe, Eastern.

4. Democracy—Europe, Eastern. I. Title.

HC244.L3749 1995

338.947—dc20

95–8199

CIP

Contents

<i>List of Tables, Boxes and Figures</i>	ix
<i>Preface</i>	xii

PART I THE PAST: REAL SOCIALISM

1 The Bases of the Socialist Economic System.	3
THE PARTY CONTROL OF THE ECONOMY	3
The Ideology	4
The Nomenklatura	4
The Economic Administration	5
Local Government	6
Self-Management	7
COLLECTIVE OWNERSHIP OF THE MEANS OF PRODUCTION	7
Socialist Ownership	8
Non-Socialist Ownership	9
CENTRAL PLANNING	10
Planning Techniques	10
A Non-Reformable System	12
Plan versus Money	13
2 History	15
THE USSR: THE STALINIST MODEL	16
The Beginnings: From War Communism to the NEP and from NEP to Stalinism	16
The Stalinist Era	20
Post-Stalinism	23
THE CREATION OF THE PEOPLE'S DEMOCRACIES IN EUROPE	23
The First Measures	24
The Shift to the Soviet Model	25
Was Yugoslavia a Different Model?	25
THE VARIANTS OF THE SOCIALIST MODEL IN THE THIRD WORLD COUNTRIES	27
3 The Reforms: Experiences and Failures	29
THE APPARENT LOOSENING OF THE PARTY CONTROL	29
New Relations Between the Centre and the Enterprise	30
A Limited Autonomy	31
The Illusions of Participation	32

A DWINDLING OF THE STATE OWNERSHIP MONOPOLY?	33
State Ownership	33
Cooperative Ownership	35
Non-State Ownership	36
COMBINING THE PLAN AND THE MARKET	37
The Principles	37
The Stalemate	39
Could Any Reform Succeed?	40
The Pervading Parallel Economy	41
4 The Performance	44
THE STRATEGY OF GROWTH	44
The Measure of Performance	44
The Aim and the Model	49
VARIANTS AND ALTERATIONS OF THE MODEL	50
The Eastern European Variants	50
The Non-European Variants	55
THE CRISIS AND THE QUAGMIRE	57
The Economic Crisis	57
The Assessment	62
5 International Economic Relations	65
'FUNCTIONAL' AUTARKY	65
State Monopoly of Foreign Trade	66
Foreign Trade Planning	67
Inconvertibility of the Socialist Currencies	68
COMECON	72
How Comecon Worked	72
How the East was Won	76
TRADE AND COOPERATION WITH THE CAPITALIST WORLD	79
The South: A Costly Partnership	79
East–West Relations: War or Peace?	82
PART II THE PRESENT: TRANSITION IN THE MAKING	
6 The End of the System	91
THE CAUSES OF THE COLLAPSE	91
The Roots	92
The Start	94
THE FIRST STEPS OF THE TRANSITION: CENTRAL EUROPE	96
The GDR: A Merger	96
The PHARE Countries	97

TRANSITION THROUGH BREAKING UP	102
The Collapse of Comecon	102
The Disintegration of the Multinational States	107
THE RESISTANCE TO TRANSITION IN NON-EUROPEAN SOCIALIST COUNTRIES	111
7 Macroeconomic Stabilisation	113
THE STABILISATION POLICIES	114
The Package	114
Tactical Choices	115
THE OUTCOME OF THE STABILISATION MEASURES	121
The Main Features of the Stabilisation Programmes	121
The Achievements in the Monetary–Financial Field	130
The Achievements in the Real Field: The Fall in Output	144
8 Privatisation and Structural Reforms	155
PRIVATISATION	155
Definitions	155
The Aims of Privatisation	158
The Mechanisms of Privatisation	159
The Lasting Difficulties of Privatisation	170
The Outcome of Privatisation: Who Controls the Enterprises?	174
OTHER AREAS OF STRUCTURAL TRANSFORMATION	179
The Banking and Financial Sectors Reform	179
The Tax Reform	183
Building a New Social Safety Network	184
Is an Industrial Policy Necessary?	185
9 Reintegrating the World Economy	191
HOW TO RECONSTRUCT REGIONAL ARRANGEMENTS IN THE EAST	191
The Rationale for a Central and Eastern European Regional Grouping	194
The Actual Arrangements in Eastern and Central Europe	198
New Trade and Payments Arrangements in the CIS Space	200
THE REORIENTATION TO THE WEST	211
The Most Advanced Framework: The Europe Agreements	214
The Steel (and Aluminium) Case	218
The Accession Queue	223
INTERNATIONAL MIGRATION ISSUES	231
Does One Need to be Afraid?	231
The Prospects for Emigration from the East	231

WESTERN ASSISTANCE TO THE TRANSITION	233
The Early Stages of Assistance to the Transition	233
The Forms of Assistance	234
The Amount of Assistance	235
The Drawbacks of Assistance	237
The Prospects of Assistance	239
10 Towards a Theory of the Transition?	241
MARKET SOCIALISM	241
Oskar Lange and the Market Socialism Blueprint	242
Objections and New Suggestions	243
Could Market Socialism Offer a Workable Post-Transition Model?	244
'REAL' SOCIALISM	246
Socialism was a Kind of Capitalism	246
Socialism was a Specific System	247
TOWARD A THEORY OF THE TRANSITION	248
Transition Leads to the Market and a Theory of the Market Already Exists	248
Transition Leads to the Market, But Slowly	249
A Country in Transition Is a Mixed Economy, Whether It Likes It or Not	251
Conclusion	254
<i>Statistical Appendix</i>	257
<i>Suggestions for Further Reading</i>	267
<i>Bibliography</i>	271
<i>Index</i>	289

List of Tables, Boxes and Figures

Tables

1.1	Simplified scheme of a material balance	11
2.1	The beginning and end of the socialist economic system	26
4.1	The Soviet growth rates (1922–85)	45
4.2	GNP levels: East–West comparisons	48
4.3	Structure of production in the socialist economies by sector and by final use, and structure of employment (1950–89)	53
4.4	Growth rates in the Soviet Union and Eastern Europe, 1950–1990	58
5.1	The issues of the ‘subsidy debate’	78
5.2	Eastern Europe and the USSR: commodity composition of trade with the West in 1990	85
6.1	The stages of the political revolution in Central and Eastern Europe, 1989–91	98
6.2	The countries of Central and Eastern Europe: official names, population and territory	100
6.3	The collapse of Comecon: ruble/dollar cross-rates end-1989	104
6.4	The former USSR and its successor states	109
7.1	The building blocks of the stabilisation-cum-transformation programmes in Central and Eastern Europe, 1989–94	122
7.2	The main instruments of the stabilisation programmes, 1990–4	128
7.3	Exchange rates, purchasing power parities and dollar wages in some countries in transition, 1991–94	140
8.1	The main issues of the privatisation process in the countries in transition	156
8.2	Foreign investment in countries in transition	163
8.3	Mass privatisation schemes	167
8.4	The outcomes of the privatisation programmes, 1990– 4	176
8.5	The social safety network	186
9.1	Patterns of foreign trade of the countries in transition, 1991–3	192
9.2	The status of the currencies in the successor states of the USSR	208
9.3	Agreements involving the countries in transition and the European Community (Union)	212

9.4	Trade in sensitive products between the EC countries and five countries in transition in 1992	217
9.5	Financial flows to Eastern Europe and to the former Soviet Union/Russia, 1990–3	236
9.6	Official aid packages for Russia	237
A.1	Eastern Europe and the USSR: exports and imports by direction, 1975, 1980, 1986, 1989	257
A.2	Macro-economic indicators of countries in transition, 1989–94	260
A.3	Unemployment in the transition countries, 1990–3	266

Boxes

2.1	Chronology of the USSR	17
7.1	The reform plans devised for the USSR/Russia	126

Figures

41.a	NMP: annual rates of change: Bulgaria, Romania, GDR	58
4.1b	NMP: annual rates of change: Czechoslovakia, Hungary, Poland	59
4.1c	NMP: annual rates of change: USSR	59
5.1	Eastern Europe and the USSR: exports and imports by direction, 1975 and 1989	73
5.2a	Eastern Europe and the USSR: commodity composition of trade	86
5.2b	Eastern Europe: exports to the West, 1990: share of sensitive products	86
7.1a	Consumer prices, 1991–4: Russia, Ukraine	131
7.1b	Consumer prices, 1989–94: Central European countries	131
7.1c	Consumer prices, 1989–94: East South European countries	132
7.2a	Budget deficit, 1991–4: Russia, Ukraine	136
7.2b	Budget deficit, 1989–94: Central European countries	136
7.2c	Budget deficit, 1989–94: East South European countries	137
7.3a	Real exchange rate index, real wage index, average monthly wage in dollars, 1990–4: Russia	142
7.3b	Real exchange rate index, real wage index, average monthly wage in dollars, 1990–4: Poland	142
7.3c	Real exchange rate index, real wage index, average monthly wage in dollars, 1990–4: Hungary	143
7.3d	Real exchange rate index, real wage index, average monthly wage in dollars, 1990–4: Czech Republic	143
7.4a	GDP index, 1991–4: Russia, Ukraine	144

7.4b	GDP index, 1989–94: Central European countries	145
7.4c	GDP index, 1989–94: East South European countries	145
7.5a	Unemployment as per cent of labour force, 1990–3: Russia	147
7.5b	Unemployment as per cent of labour force, 1990–3: Central European countries	147
7.5c	Unemployment as per cent of labour force, 1990–3: East South European countries	148
7.6a	Number of unemployed, 1990–3: Russia	148
7.6b	Number of unemployed, 1990–3: Central European countries	149
7.6c	Number of unemployed, 1990–3: East South European countries	149

Preface

‘Until recently the world was divided into the first, second and third world. The notion of the second world is now losing its substance. What remains is a huge amount of debris and ruins which is a combination of the first and third worlds: by its aspirations and longing to create a democratic political system and prospering market economy it relates to the first world, a part of which it would like to become; however, by the state of the economy and the types of national and social problems it often resembles the third world.’ (Vaclav Havel, President of the Czech and Slovak Federal Republic, 4 September 1991, Prague, opening speech of the International Forum for Culture and Democracy)

Since the Berlin Wall was breached on 9 November 1989, the former socialist countries have remained on top of the agenda in the Western media, not only because of dramatic political developments such as the anti-Gorbachev coup and the collapse of the USSR in 1991, or because of the lingering state of war in the former Yugoslavia and in parts of the former USSR. Economic developments make headlines as well. The transition to the market arouses public interest out of proportion to the share of these countries in the world economy. Western governments, firms, international organisations and ordinary citizens, are eager to keep informed, to understand, to help, to advise, to trade, to invest, to be involved in one way or another.

At the same time, after several years of transition, frustrations and even a kind of fatigue develop in the West. Though transition to the market is now acknowledged as a longlasting process which might extend to a whole generation, structural transformation seems very slow. While growth has resumed in Eastern Europe, there are only a few signs of the possible ending of a protracted recession in Russia. Along with this gloomy assessment, the West increasingly feels the impact of the East, in many ways. East and West are now parts of the same world. In the past, following the usual international classification, one could divide the world into three parts: the developed market economies, or, in the parlance of the East, the capitalist world; the ‘second’ world of the centrally planned economies, which used to call itself socialist; the Third World of the developing economies. Now there is just an economic division between rich and poor countries. There is no longer a systemic division. The market economy has won. What is the price of this victory? Will the Western model succeed in the East? Will the rich Western countries be able to go on supporting the South

and at the same time pull the East up to their average level of development? What does this imply in terms of assistance, market liberalisation, and increased immigration? Are our recipes and programmes really suited for the transition process? If these programmes do not work as they should, is the model to be blamed?

Much has already been written on transition. Reports, conference materials, collective books, guides for businessmen, and scholarly articles in specialised and non-specialised journals, have flourished. It is fairly impossible to follow this surge in the literature, and to avoid being overtaken by events. It looks therefore provocative to offer a textbook by one single author on such a fast-moving subject. The purpose and the approach need to be clarified.

The author of this book has been studying Soviet and Eastern European economies for over thirty years. Thus, I belong to the professional world of what used to be called 'sovietology'. This profession is feeling very frustrated lately. Since the beginning of the transition many new experts have come into the field, from various backgrounds, mainly from an experience in developing countries. Many of the former 'sovietologists' have lost credibility, because none of them had predicted that the system would collapse when it did, or the way in which a collapse would occur, and also because they were suspected of bias due to their involvement in the study of a now dead system. Personally I do not feel guilty of lack of foresight. We all were wrong: both those who year after year predicted that the system was bound to collapse, and those, more cautious, who thought it might go on muddling through for many years. Many of us believed that the system might last longer if reformed, and we had even devised the categories of 'modified' or 'reformed' planned economies. The sudden end of the system took everybody by surprise, as well as the radical shift to the market, which excluded any 'third way'. Does this mean that we may now dispense with any understanding of the past? The present transition process has no historical equivalent or precedent, such as the situation of the Western European countries after the Second World War, or the evolution in the developing countries. The transition is burdened with the legacies of the past. This past has to be assessed, especially as history is being rewritten due to new information and new statistical data now available. Slowly, 'the figure in the carpet' reveals itself. Knowledge of the past helps to understand the inertia of the present. History also evidences that the fruit was rotten, through dozens of signs that we know how to decipher only now; thus the present provides us with keys to explain the past.

This book is concerned with economics. Is there such a thing as 'transition economics'? In the past there was a wide debate in the profession as to the relevancy of mainstream economics to the analysis of centrally planned economies. Whatever the answer in theory, in practice it was very difficult to

use any sophisticated econometric model for lack of reliable data. Now there seems to be a wide consensus on the theory. In the East, while communism has been discarded politically, and even outlawed in some countries (for instance, in the Czech Republic), economists and policy-makers alike endorse the fundamentals of neo-classical economic science. Their Western advisers eagerly support this attitude, especially as the standard adjustment and stabilisation packages which they recommend are based on the same theoretical assumptions. I believe that the disillusion in the transition process will lead to a more complex approach, closer to the 'political economy' concept. This concept is generally considered with suspicion both in East and West. It is reminiscent of Marx, more than of Ricardo. It suggests at best a reluctance, at worst an inability to use mathematical formalisation. Beyond such simplifying views, one may find an inspiration in new approaches such as the institutionalist one, and in the combination of economics with political science and history. The last chapter of this book explores these alternatives approaches.

This book is also the outcome of a personal involvement. I have been travelling in East Central Europe and in the USSR since 1964. I have witnessed the first year of the transition in Prague in 1990–1. I have many personal friends in all these countries. Therefore I cannot look at the transition from a mere scholarly point of view. I want the transition to succeed, and I sense all the sorrows and pains associated with this process, which looked so exhilarating in the beginning. I have a special thought for my Russian friends. Not only are they facing the damages and losses resulting from the past regime, which they had to bear for so long; and not only, in their own private lives, are they looking back at their wasted years, and anticipating an uncertain and difficult future for their children. But also, they are explicitly or implicitly burdened with a collective guilt for what their leaders have imposed upon others. Their native motherland has vanished; its name is associated with infamy, and glorious memories are wiped out. The 900 days during which Soviet Leningrad resisted the enemy sink into oblivion while St Petersburg is born again. Transition is irreversible: nobody wants the communist past to be revived, but should all of it be doomed?

Finally, let me add a few methodological notes. The book is divided into two parts, the first one dealing with the past of the centrally planned economies under 'real socialism', the second exploring the transition in progress. Central and Eastern European countries, together with the former USSR, are mainly considered here; other experiences are mentioned but not elaborated upon.

The book is targeted for students in economics, political science, and history of Eastern Europe. Though designed for undergraduates and not requiring a preliminary acquaintance with the subject, it may also be used

on advanced courses as an introduction to transition economics. For teachers and graduate students, a guide for further reading provides opportunities for a deeper investigation. The book is also meant for the general public wanting a simple and clear approach to the complex issues of the transition to the market. It does not pretend to convey detailed information on all its aspects for all the countries under review. This is why, contrary to almost all the books devoted to this topic, no country studies are presented. The purpose is to offer basic and comprehensive guidance to the essentials, so that the reader may use what he/she already knows about the past of this area, sort out the huge volume of information brought to him or her by the media day by day, and follow up on his/her own through further reading.

A book on such a topic cannot be definitive. The process analysed is transitory by definition. People and governments in the East have to go through and out of transition; international organisations, states, and experts in the West are busy helping, advising, monitoring, and observing the process. The ultimate aim is not to create a new type of society, a new system. The East wants to rejoin the developed West where it stands. To reconstruct a market economy is, however, a long and complex task: we know where we start from, we believe we know how to get there, but we cannot know exactly what the outcome will be. The story is still open-ended.

* * *

I could not have written this book (as well as the shorter French book on which the present volume elaborated and expanded, *L'Europe de l'Est, du plan au marché*) without various favourable circumstances such as fruitful contacts and discussions in several research centres in the beginning of the transition. I would like to acknowledge the research support of the European University Institute (1988), of the Bundesinstitut für internationale und ostwissenschaftliche Studien (BIOST) in Cologne (1989), of the Averell Harriman Institute at the Columbia University and of the Institute for East-West Studies (IEWS) in New York (1990). I had the great privilege of being appointed by the IEWS as the director of its Central European branch, the European Studies Centre in Prague (1990–1), and this gave me the invaluable opportunity of witnessing the first steps of transition in a former communist country, as well as the privilege of working with a team of people enthusiastically dedicated to assisting the transition process. I was associated for two years (1991–3) with the Programme for Strategic and International Security Studies of the Graduate Institute for International Studies in Geneva. With the support of the French Ministry of Education and of my university, I organised in 1992 an international 'summer school' on the transition to the market which again allowed me to develop exciting intellectual contacts.

I cannot formally express my gratitude to all the friends, colleagues, specialists and institutions who actually helped me in devising this book, gathering the material, and clarifying my ideas. I earnestly apologise for not mentioning everybody toward whom I have an intellectual debt. Among the few names I want to mention, I shall begin with two dear friends of many years, with whom I have repeatedly discussed the issues of feasible or unfeasible socialism, and who both died in 1994: Alec Nove, Emeritus Professor at the University of Glasgow and father of the British sovietology, and Aleksandar Vacic, the head of the Division for Economic Analysis and Projections at the Economic Commission for Europe of the United Nations in Geneva. Several friends agreed to read the manuscript and to comment; I am especially grateful to Joel Dirlam, Marvin Jackson, Viktor Kuznetsov, Harriet Matejka, and Mario Nuti, for their attention and their remarks. All conclusions and remaining errors are mine.

Pau, France

MARIE LAVIGNE